ST 02-2
Tax Type: Sales Tax
Issue: Responsible Corporate Officer – Failure to File or Pay Tax

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	
v.	No. 99-ST-0000 NPL: 0000 NOD: 0000
JOHN DOE, as Responsible Officer of ABC, Inc.,	
Taxpayer	

RECOMMENDATION FOR DISPOSITION

Appearances: Stephen A. Gorman, Esq. on behalf of John Doe and Marc L. Muchin and George Foster, Special Assistant Attorney Generals on behalf of the Illinois Department Of Revenue.

SYNOPSIS:

This matter arose following the issuance of a Notice of Penalty Liability and a Notice of Deficiency by the Illinois Department of Revenue ("Department") to John Doe ("Doe" or "taxpayer"). NPL No. 0000 assessed a penalty equal to the unpaid retailers' occupation tax ("ROT") liability of the ABC, Inc. for November and December of 1994 and January and February of 1995. NOD No. 0000 was issued for unpaid withholding taxes incurred by ABC, Inc. for the fourth quarter of 1994 and the first and fourth quarters of 1995. After a review of the evidence, it is recommended that the NPL and the NOD be affirmed in their entirety as revised by the parties' stipulation.

FINDINGS OF FACT:

1. The Department's established its *prima facie* case, inclusive of all jurisdictional elements, by the admission of the Notice of Penalty Liability No. 0000 issued to John Doe on February 17, 1998 in the amount of $64,309.93 and a Notice of Deficiency No. 0000 issued on February 18, 1998 for $40,243.69. Dept. Ex. Nos. 1 & 2.

2. The parties stipulated that after the proper application of a withholding tax payment of $22,553.49 made by ABC, Inc., the amount of withholding tax in controversy in this proceeding that relates to the first quarter of 1995, is $1,282.13, not including any interest or penalty which may be claimed respect to the same. Group Ex. No. 2; Tr. p. 25.

3. Doe worked for ABC, Inc. or one of its predecessors from approximately September of 1991 through March 12, 1995. Tr. p. 31.

4. ABC had two major divisions, the first division manufactured metal garage doors and the second division handled the installation of garage doors for new homebuilders. Tr. pp. 32, 33.

5. Doe was the vice-president of finance during the audit period. Tr. p. 29. Doe' job responsibilities included handling bank relations, preparing financial statements, handling credit and collection and working with the outside auditors. Tr. p. 29.

6. Doe’ job duties as vice-president of finance also included overseeing the accounting section. Tr. p. 86. Doe worked at ABC on a daily basis. Tr. p. 86. (Doe’ testimony).

7. Doe also oversaw credit and collections and was given daily reports. Tr. p. 87. Doe received a daily report of the company’s cash receipts and received a report showing an aging of accounts receivable. Tr. p. 87. Doe received an aging of accounts payable on a monthly basis. Tr. p. 88. (Doe’ testimony).

8. During the audit period, Mr. Smith was the president of ABC, Inc. and owned 96% of the company. Tr. pp. 28, 34, 105, 106.

9. Mr. Smith hired Doe as the chief financial officer. Tr. p. 106.

10. Mr. Jones was the executive vice-president in charge of operations. Joe Doe was the general manager in charge of the sales-service division. Tr. p. 33.

11. Joe Blow was ABC’s attorney and secretary of the corporation. Joe Blow, Mr. Jones and Mr. Smith were members of the board of directors during the audit period. Tr. pp. 36, 122.

12. Doe was a signatory on two bank accounts, the payroll account and the company’s general account. Tr. p. 42. Two signatures were required on company checks. Tr. p. 42.

13. Doe signed payroll and general bank account checks throughout the entire audit period. Tr. p. 87 (Doe’ testimony).

14. Mr. Smith, Joe Doe and Mr. Jones also had signatory authority on the corporate bank accounts. Tr. p. 42.

15. Mrs. Smith was the accounting manager. Mrs. Smith handled accounting records such as the company's sales journal and the cash receipts journal. Tr. p. 37. Mrs. Smith also prepared the sales tax returns throughout the audit period. Tr. pp. 37, (Doe' testimony), 151, 152 (Mrs. Smith's testimony).

16. Mrs. Smith reported to Doe during the audit period. Tr. p. 148. During the end of 1994 and 1995, after Jane Doe left, Mrs. Smith was responsible for the accounts payable as well as her other duties, and Doe directed her as to which creditors were to be paid. Tr. pp. 148, 149.

17. Mrs. Smith prepared and signed the sales tax returns for November and December of 1994 and January and February of 1995. Tr. pp. 70, 71, 159; Taxpayer Ex. Nos. 3-6. After preparation, Mrs. Smith gave the sales tax returns to Doe for review. Tr. pp. 154, 158. (Mrs. Smith's testimony).

18. Mrs. Smith, the accounting manager reported to Doe when he started in 1991 and continued reporting to him throughout 1994 and 1995. Tr. p. 83 (Doe' testimony).

19. When bills needed to be paid, Mrs. Smith would report the accounts payable to Doe and request the money to pay these creditors. This office routine occurred from 1991 when Doe started at ABC and continued throughout 1994 and 1995. Tr. pp. 83, 84, 85. (Doe' testimony).

20. Mrs. Smith supplied the daily sales figures to Doe for preparation of the bank statement. Tr. pp. 46, 47, 87, 88.

21. Doe needed these daily sales figures to calculate the amount available for the company to borrow pursuant to the asset based financing arrangement it had with the bank. Tr. p. 47.

22. When Doe started in 1991, the company was paying its creditors on a timely basis. Tr. p. 47. Doe was aware that business was declining throughout the audit period and the company started losing some of its customers due to bankruptcy. Tr. pp. 48, 49. During the audit period, many of their major suppliers put the company on credit hold and supplies were delivered on a cash on delivery basis. Tr. p. 53. (Doe' testimony).

23. Meetings were held at the end of 1993 and throughout 1994 during which the participants discussed the company's business activities. Doe, Mr. Smith, Mr. Jones, Joe Doe and Jill Doe attended these meetings. Tr. p. 52. The meetings took place in the office conference room and were conducted by Mr. Smith. Tr. p. 53. Generally, the main topic of the meeting was the upcoming week's production schedule and the company's material needs. Tr. p. 53. (Doe' testimony).

24. Ron Doe was ABC's C.P.A. In the mid-1980s his firm was engaged to do the audit and tax work for one of ABC's predecessors, ABC Industries. Tr. p. 90. Subsequently, Ron Doe's firm was involved in the audit and tax work of ABC from about 1990 through the company's demise in 1995. Tr. pp. 90, 91. Ron Doe was the partner primarily responsible for the ABC account. Tr. p. 91.

25. Ron Doe's C.P.A. firm's responsibilities for ABC included forecasting financial information, assisting with banking relationships, performing audit and tax work and tax return preparation for the individual shareholders as well. Tr. pp. 92, 93, 96. ABC was organized as a Subchapter S company. Tr. p. 93.

26. Ron Doe met with ABC's management throughout the audit period. Most of Ron Doe's work for ABC was done at year-end. Tr. p. 93.

27. Doe or someone under his supervision compiled a list of accounts payable during the audit period. Tr. p. 102. (Ron Doe's testimony).

28. Mr. Smith personally guaranteed the debts of the company to the bank. The company financed operations through asset-based borrowing. Tr. p. 96 (Ron Doe's testimony).

29. Jane Doe and later Jill Doe handled the payroll responsibilities for ABC, Inc. Tr. p. 152. (Mrs. Smith's testimony). Jill Doe prepared payroll reports for John Doe during the audit period. Tr. pp. 164, 165. (Jill Doe's testimony).

30. Doe remained a signatory on the bank accounts throughout the entire audit period. Tr. pp. 67, 68, 69.

31. During the audit period, Doe loaned the company $80,000. Tr. pp. 124, 125. The company did not pay back the loan to Doe. Tr. p. 125. Mr. Smith personally guaranteed the payment of the loan to Doe, however, Mr. Smith never honored the personal guarantee. Tr. p. 139.

32. In approximately the middle of March, the assets were turned over to an assignee. Tr. pp. 76, 78. On May 1, 1995, Doe became an employee of United Dominion Bank, the company who purchased ABC's assets. Tr. p. 78. ABC filed bankruptcy. Tr. pp. 78, 79.

33. After March of 1995, Doe was no longer a signatory on the corporate bank account. Tr. p. 78.

<u>CONCLUSIONS OF LAW:</u>

The Department seeks to impose personal liability upon Doe in this matter as a responsible officer under Section 3-7 of the Uniform Penalty and Interest Act ("UPIA"). Section 3-7 of the UPIA provides in part as follows:

> "Any officer or employee of any taxpayer subject to the provisions of a tax act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who wilfully fails to file the return or make the payment to the Department or wilfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon." (35 ILCS 735/3-7(a)).

An officer or employee of a corporation may therefore be personally liable for the corporation's taxes if (1) the individual had the control, supervision or responsibility of filing the returns and paying the taxes, and (2) the individual willfully failed to perform these duties.

The Department established its *prima facie* case when it introduced the NPL and NOD into evidence under the certificate of the Director. 35 **ILCS** 735/3-7(a)-(b); <u>Branson v. Department of Revenue</u>, 68 Ill.2d 247, 261, 659 N.E.2d 961, 968 (1995). The Department's *prima facie* case is a rebuttable presumption. <u>Id</u>. After introduction of the NPL and NOD, the burden shifts to the taxpayer to prove that one or more elements are lacking. A taxpayer cannot overcome the presumption merely by denying the accuracy of the Department's assessment or by denying knowledge of a tax deficiency. <u>Branson</u>, 68 Ill.2d at 267, 659 N.E.2d at 971 ("…lack of willfulness is not proved simply by denying conscious awareness of a tax deficiency that could have been easily investigated by an inspection of corporate records.").

At hearing, the taxpayer introduced copies of the company's sales tax returns for November and December of 1994 and January and February of 1995. The accounting manager, Mrs. Smith, acknowledged that she prepared and signed each of these tax returns. This fact, in of itself, however, does not absolve taxpayer of responsibility for ABC's unpaid taxes because it is clear under the plain text of § 3-7 of the UPIA, that more than one person may be a responsible officer or employee. 35 **ILCS** 735/3-7(a) (penalty to be assessed against "[a]ny officer or employee…" with the requisite status and authority, and who acts willfully); *see also*, e.g. Estate Of Young v. Department of Revenue, 316 Ill. App. 3d 366 (1st Dist. 2000) (affirming the assessment of penalty against one brother and the estate of another who were, respectively, vice-president and president of a corporate taxpayer).

In the case at hand, Doe was ABC's vice-president of finance. During the tax period, Doe was a signatory on the bank accounts as well. More importantly, at hearing, Doe admitted that he oversaw the accounting department and that Mrs. Smith, the accounting manager reported to him. Tr. pp. 83, 86. Doe asserts, however, that he did not review the sales tax returns during the audit period and was not involved in their preparation. His testimony is directly contradicted by that of his staff member, Mrs. Smith. At hearing, Mrs. Smith corroborated Doe testimony that she reported to him throughout 1994 and 1995 and that she prepared the sales tax during that period as well. Additionally, Mrs. Smith gave credible testimony that every month after preparing the sales tax return, she gave the returns to Doe for his review. Whether Doe chose to actually review them or not is irrelevant, because the fact remains that he undisputedly oversaw and supervised the individual who actually prepared the tax returns and, therefore, was ultimately responsible for their content and their filing. It is reasonable to conclude that Doe, as Mrs. Smith's supervisor, reviewed her work during the tax period. Further, Doe acknowledged that he signed checks throughout the audit period. Since Mrs. Smith was not a signatory on the bank accounts, Doe, as Mrs. Smith's supervisor, would have been one of the signors on the sales tax remittance check. Although it is true Doe could supply only one of the two required signatures on the check, as vice-president of finance and as one who oversaw the preparation of the returns, he was responsible for ensuring that payment was made.

Further, with respect to the withholding tax returns at issue, Doe claims he did not prepare or supervise the preparation of the withholding tax returns. Jane Doe and later Jill Doe handled the payroll function for the company and Jill Doe testified that she prepared payroll reports for him during the audit period. Tr. pp. 164, 165. While it remains unclear who prepared and signed the withholding tax returns at issue, it is taxpayer's burden to prove that he was not responsible or did not supervise individuals who were responsible for the preparation of the withholding tax returns. Branson, *supra*. Taxpayer has not sustained his burden since at hearing he did not produce credible documentary and testimonial evidence which proved that he was not a responsible in any way for the preparation or review of the payroll reports and the withholding tax returns in his role as vice-president of finance and supervisor of the accounting section.

"Willful" under the statute is defined as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious known risks. *See*, Branson at 254-56; Department of Revenue v. Heartland Investments, Inc. (1985), 106 Ill. 2d 19. Willful conduct does not require bad purpose or intent to defraud the government.

Branson at 255; Heartland at 30. Wilfulness may be established by showing that the responsible person (1) clearly ought to have known that (2) there was a grave risk that the taxes were not being paid and (3) the person was in a position to find out for certain very easily. Wright v. United States, 809 F.2d 425, 427 (7th Cir. 1987). Furthermore, whether the person in question wilfully failed to pay the taxes is an issue of fact to be determined on the basis of the evidence in each particular case. Heartland at 30; Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill.2d 568, 577 (1977). Courts have found that giving preferential treatment to creditors rather than paying the corporation's taxes constitutes willful behavior. Heartland at 29-30.

At hearing, Doe testified that Mr. Smith directed which vendors should be paid. However, the taxpayer's own witness, Ron Doe, the corporation's outside C.P.A. acknowledged at hearing that during the audit period, it was Doe who compiled a list of accounts payable or directed someone under his supervision to compile such a list. Tr. p. 102. Although Ron Doe testified that in his opinion Mr. Smith was ultimately responsible for deciding which creditors were to be paid, it is unclear how he reached this conclusion. While it is true that Ron Doe may have met with management throughout the year, as the outside accountant he did not work at ABC on a daily basis nor did he interact with Mr. Smith, Doe and the other corporate officers on a daily basis. Ron Doe's work at ABC was primarily done at year-end and was focused upon auditing the financial statements. Although Ron Doe testified that Mr. Smith was a hands on president, this does not preclude a finding of liability against Doe as well since there may, in fact, be more than one responsible officer in a corporation. Thus, Ron Doe's observations and conclusions at hearing can not be determinative on the issue of whether Doe acted as a responsible officer during the audit period.

Further, Mrs. Smith gave credible testimony that she was responsible for the accounts payable during the last part of 1994 and 1995 after Jane Doe left. Mrs. Smith further testified that Doe directed her as to which creditors should be paid. Mrs. Smith's testimony is reasonable given that Doe acknowledged that he was aware that that the company was preferring some creditors over others to ensure that production needs were met. Doe also acknowledged that he received reports reflecting the aging of both the accounts receivables and the accounts payable during the audit period. These reports would have included the account payable to the Department as well as suppliers. Even assuming that Doe was not directly aware that the sales and withholding taxes owed to the Department of Revenue were delinquent, Doe knew that the company could not pay all its creditors on time and he knew the company's business was rapidly deteriorating. This knowledge coupled with his responsibility and supervision of the preparation and filing of sales tax and withholding tax returns establishes that Doe ought to have known that there was a grave risk that the taxes were not being paid.

As vice-president of finance he was in a position to find out for certain, yet he failed to do so. The fact that Doe simply let others under his supervision handle the actual preparation of the tax returns while he concentrated on other tasks does not relieve him of liability. Wright v. United States, 809 F. 2d 425 (7th Cir. 1987), accord, Calderone v. United States, 799 F. 2d 254, 260 (6th Cir. 1986), quoting Bolding v. United States, 565 F.2d 663, 674 (1977) ("Thus, it cannot be that 'a responsible officer may immunize himself from the consequences of his actions by wearing blinders which will shut out all knowledge of the liability for the nonpayment of [the corporation's] withholding taxes.'"). Accordingly, Doe' actions during the period at issue can be said to be willful under Section 3-7 of the UPIA.

Finally, taxpayer points out that he resigned as an officer in December of 1994, and merely stayed on as an employee. Although taxpayer claims he resigned his officer position, he admits he never advised his boss, Mr. Smith, the individual he alleges controlled all aspects of the company's daily business, of this resignation. Tr. p. 68. Taxpayer never attempted to explain this unusual circumstance. Further, taxpayer's job duties remained the same after this letter was purportedly given to the corporate secretary. Tr. pp. 67-69. So, even if such an attempt to resign were found effective, taxpayer remained both responsible and willful for the remaining period, the first quarter of 1995, since the statute specifically provides that personal liability may be imposed upon an employee as well as an officer.

Wherefore the reasons stated above, it is my recommendation that the Notice of Penalty Liability and the Notice of Deficiency should be affirmed in their entirety as revised by the parties' stipulation.

Date: December 21, 2001

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Christine O'Donoghue
Administrative Law Judge